NOTE 27 – RISK MANAGEMENT

A. Primary Government

General

The State has elected not to purchase commercial insurance for many of the risks of losses to which it is exposed. The State is self-insured for most general liability and property losses, portions of its employee insurance benefit and employee bonding programs, automobile liability, and workers' compensation and unemployment compensation claims. Areas of risk where some level of insurance coverage is purchased include: aircraft liability, property and loss of rents insurance that may be required by bond or lease agreements, portions of the State employee insurance benefits program, certain State artifacts, builder's risk coverage, boiler and machinery coverage, and employee bonding. Settled claims have not exceeded commercial coverage in any of the past seven fiscal years.

The State has established two internal service funds, which are described below, to account for certain aspects of the risk management program. Fund expenditures for these types of risks are recognized in the paying funds in a manner similar to purchased commercial insurance. For other uninsured losses not covered by an internal service fund program, the State recognizes fund liabilities in the fund incurring the loss when it is probable that a loss has occurred and the amount can be reasonably estimated. As explained more fully in Note #14, losses for workers' compensation and certain types of litigation losses have been recognized as liabilities in the General Long-Term Obligations Account Group, with expenditures recognized when due and payable.

For unemployment claims, the Unemployment Agency (UA) bills the State for the actual amount of claims paid to former State employees. The State accrues liabilities for unemployment compensation only to the extent of the amount paid by UA through September 30. During the 1999-2000 fiscal year, expenditures for payments to former State employees (not including university employees) totalled $4.4 million. The potential liability for future payments has not been estimated.

The State's two internal service funds, which account for certain areas of risk management, follow accounting standards established by the Governmental Accounting Standards Board. This results in a reporting which is very similar to that used in the private insurance industry. The various component programs within the two funds may incur deficits during a given year, but each program's surplus, retained earnings balance, or deficit is considered in calculating future charges or benefit levels.

Risk Management Fund

This fund was established during fiscal year 1989-90 to account for insurance management activities implemented within the Department of Management and Budget. The automotive liability and administrative functions are accounted for as operating activities of this fund. Expenses and liabilities for claims, including incurred but not reported or not processed claims, have been recorded in the amount of $8.0 million. This includes a long-term portion, which is recorded at $5.5 million.

Changes in the Risk Management Fund's claims liability for automobile liability for the fiscal years ending September 30, 2000 and 1999 are as follows (in millions):

	2000	1999
Balance - beginning	$ 6.9	$ 5.6
Current year claims and Changes in estimates	1.8	5.2
Claim payments	(.8)	(4.0)
Balance - ending	$ 8.0	$ 6.9

State Sponsored Group Insurance Fund

The Department of Management and Budget uses this fund to account for employee and retiree insurance benefit programs, which are largely self-funded. Expenses and liabilities for claims, which include incurred but not reported or not processed benefit claims, based on preliminary estimates from the plan administrators, have been recorded as liabilities in the amount of $184.0 million. This includes a long-term portion which is recorded at a discounted present value of $89.3 million using a discount rate of 10.5% (first 15 years of disability), 9.0% (next 5 years), and 6.0% thereafter. Claims incurred in past years were discounted using rates as follows in the calculation of incurred but not reported claims: 1993 and 1994 used a rate of 6.0%, 1995 used a rate of 6.25%, 1996 and 1997 used a rate of 5.75%, and 1998 through 2000 used a rate of 5.25%.

Payments to the State Sponsored Group Insurance Fund are based on estimates of amounts needed to pay prior and current year claims. In addition, a portion of the fund's retained earnings has been designated for catastrophic losses. The risk management designation represents the level of reserves that should be maintained to ease large fluctuations in premium levels in years of unexpected excessive claims. That designation was $54.3 million at September 30, 2000. Retained earnings totaled $12.9 million at September 30, 2000. Therefore, if excessive claims were realized, the fund would not have sufficient retained earnings to satisfy these losses.

Changes in the State Sponsored Group Insurance Fund's claims liability for employee and retiree insurance benefit programs for the fiscal years ending September 30, 2000 and 1999 are as follows (in millions):

	2000	1999
Balance - beginning	$ 173.7	$ 166.4
Current year claims and changes in estimates	494.6	485.6
Claim payments	(484.3)	(478.3)
Balance - ending	$ 184.0	$ 173.7

Note 27 continued on next page.

B. Discretely Presented Component Units

State Universities

The State university component units participate with the other Michigan public universities in the Michigan Universities Self-Insurance Corporation (MUSIC), which provides indemnity to its members against comprehensive general liability, errors and omissions losses, and property damage commonly covered by insurance. Loss coverages for comprehensive general liability and property are structured on a three-layer basis with each member retaining a portion of its losses, MUSIC covering the second layer, and commercial carriers covering the third layer. For all policy years through June 30, 1993, errors and omissions coverage was structured on a two-layer basis with no excess insurance provided. Effective July 1, 1993, MUSIC obtained excess insurance coverage from commercial carriers covering the third layer. For automobile liability there is no member retention. Comprehensive general liability, property and automobile liability coverage is provided on an occurrence basis; errors and omissions coverage is provided on a claims made basis.

The universities made initial capital contributions and make premium payments to cover administrative costs, the cost of obtaining excess insurance coverage, and claims for risk retained by the facility. Premiums to facility participants are adjusted based on the difference between actual claims and the amount of claims originally estimated for a year. Liabilities for estimated losses retained by the universities under MUSIC have been established in the operating funds of the universities.